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In the Supreme Court of the United States

OCTOBER TERM, 1992

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

v.

OHIO POWER COMPANY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

1. a. The court of appeals' decision in this case rests on two independent grounds—the court's interpretation of Section 13(b) of the Public Utility Holding Company Act of 1935 (PUHCA), 15 U.S.C. 79m(b), and its interpretation of FERC's own regulation, 18 C.F.R. 35.14(a)(7). In the court of appeals' view, both the statute and the regulation prohibit FERC from doing anything other than permitting respondent to pass through to its rate-payers the full cost of whatever amount of coal respondent chooses to purchase from its subsidiary, the Southern Ohio Coal Company (SOCCO).

Respondent argues that further review is unwarranted in this case because "FERC is free to amend its regulation" to make its intended meaning clear. Br. in Opp. 13. As we explain in our certiorari petition (at 23), however, an amendment would be futile. If FERC applied any such amended regulation to an inter-affiliate transaction like the one at issue here, the District of Columbia Circuit—which has jurisdiction to review all FERC orders, see 16 U.S.C. 825*l*(b)—would be bound by its statutory holding in this case to reverse FERC's decision.

Neither of the cases cited by respondent (Br. in Opp. 13 n.9) suggests that in a situation like this the existence of a holding by the court of appeals concerning the meaning of a regulation ought to shield the court's dispositive statutory holding from further review. Both cases involved "circumstances * * * which 'were not . . . fully apprehended at the time certiorari was granted.'" *The Monrosa* v. *Carbon Black Export, Inc.*, 359 U.S. 180, 183 (1959); see *Belcher* v. *Stengel*, 429 U.S. 118, 119 (1976). Moreover, in *Belcher*, those circumstances consisted of facts not disclosed in the certiorari petition that undermined the factual predicate of the single question on which certiorari was granted and, indeed, rendered it impossible for the Court to reach that question. 429 U.S. at 119.

In this case, by contrast, two separate questions are plainly set out in our petition. Neither question is legally or logically antecedent to the other, and there accordingly is no impediment on the facts of this case to the Court's ability to decide the statutory question first. Then, if the Court agrees with our submission that FERC is not ousted as a statutory matter from jurisdiction to determine whether the rates charged by Ohio Power are just and reasonable,

it may decide whether FERC has tied its own hands, through the regulation on which respondent relies, in the exercise of that jurisdiction. Moreover, each holding below will independently preclude FERC from exercising the authority Congress conferred on it to regulate a holding company subsidiary's pass-through of costs incurred in inter-affiliate transactions—not only in this case, but also in any future case in which the subsidiary seeks to pass such costs through to its ratepayers. Accordingly, the fact that the court of appeals decided the case in the alternative on regulatory grounds does not detract from the breadth of the court's statutory holding or the need for further review now.

b. Respondent contends (Br. in Opp. 14-16) that, notwithstanding the fact that courts are divided concerning whether the term "deemed" creates a conclusive or rebuttable presumption, that term as used in 18 C.F.R. 35.14(a)(7) should be understood to create a conclusive presumption because in respondent's view the "weight of authority" has so construed that word. Br. in Opp. 15. When a term used in a regulation is ambiguous, however, the fact that many courts have construed the term, in entirely different contexts, in a way at odds with the interpretation of the agency is insufficient to overturn the agency's construction. On the contrary, an agency's interpretation of its own regulation is "of controlling weight unless it is plainly erroneous or inconsistent with the regulation." *Udall* v. *Tallman*, 380 U.S. 1, 16-17 (1965).

Moreover, as we explain in the petition (Pet. 24-25), FERC's interpretation is the only one that makes sense in light of FERC's mission to ensure that rates are just and reasonable, and in light of the language's place in a regulation that governs only what charges

may be included in fuel adjustment clauses and charged to ratepayers in the first instance, not the *final* approval of rates. As the concluding sentence of the regulation makes clear, "[f]uel charges by affiliated companies which do not appear to be reasonable may result in the suspension of the fuel adjustment clause or cause an investigation thereof to be made by [FERC]." 18 C.F.R. 35.14(a)(7). Although respondent asserts that this provision for a later investigation "applies only to affiliate fuel purchases that are not subject to price regulation by another agency" (Br. in Opp. 15 n.12), it points to no basis for that limitation in the unqualified language of the regulation.

The statutory provision governing fuel adjustment clauses likewise militates against such an implied limitation on FERC's authority. It provides that FERC may, on its own motion or upon complaint, order the utility to "modify the terms and provisions of *any* automatic adjustment clause" and "cease *any* practice in connection with the clause" if it "does not result in the economical purchase and use of fuel, electric energy, or other items, the cost of which is included in any rate schedule under an automatic adjustment clause." 16 U.S.C. 824d(f)(3) (emphasis added). Nothing in this statutory text suggests that FERC may disclaim this authority through promulgation of a regulation that ties its hands in the manner the court of appeals found.

2. a. Respondent's principal contention concerning the court of appeals' statutory holding is that the decision below "did not rest on the statute, or even on the SEC's regulations implementing it," but rather rested on "the orders issued by the SEC with respect to this transaction," and that the question of the proper interpretation of those orders would not warrant further review by this Court. Br. in Opp. 17.

Respondent's effort to narrow the court of appeals' holding has no basis in the court's opinion or in the text of PUHCA or the SEC regulations.

The court of appeals found "the resolution" of the issue it believed to be presented by this case "in the plain language" of Section 13(b) of PUHCA, which "directs the SEC to price [covered] goods 'at cost, fairly and equitably allocated among [associate] companies.'" Pet. App. 11a. The court noted that the "specific *statutory* mandate to establish a cost-based price for sales of goods between associates" had no analogue in the Federal Power Act administered by FERC, and the court resolved the "conflict" it perceived through resort to the "black letter law that when a conflict arises between specific and general provisions of the same *legislation*, the courts should give voice to *Congress's* specific articulation of its policies and preferences." *Ibid.* (emphasis added). The court accordingly "h[e]ld that *Congress* * * * authorized the SEC to set the price of SOCCO coal 'at cost,' and in so doing constrained FERC from altering that price under its 'just and reasonable' rate-setting authority." *Ibid.* (emphasis added).

Indeed, the court of appeals *rejected* FERC's argument that the SEC orders approving the various Ohio Power-SOCCO transactions had significance independent of the statute, because those orders had not embraced a strict at-cost standard, but had instead simply placed a cost-based ceiling on the price SOCCO could charge Ohio Power for coal. The court of appeals held that the wording of the orders "does not diminish the exclusive role cost plays in establishing associate prices—*Congress's* use of the term 'at cost' indicates that cost serves as a ceiling and a floor." Pet. App. 13a (emphasis added). The court went on to add that "*Congress* did not make

room for anyone other than the SEC to exercise" any discretion to depart from the statutory at-cost standard, and it determined that the SEC had not done so here. *Ibid.* (emphasis added). Finally, the court made clear that the strict at-cost standard was imposed by PUHCA itself, as well as by the SEC—*i.e.*, it was "prescribed by §13(b) and the 1971 SEC order." *Ibid.* In short, in the court's view, the significance of the SEC orders in this case was simply that they followed the statutory mandate.[1]

b. Respondent also contends that "FERC did not suggest to the court of appeals the analysis that it now asserts was mandated by this Court's remand." Br. in Opp. 18. That contention is mistaken. The first argument advanced in FERC's brief before the court of appeals was that "regulation of the same subject matter by two agencies is a prerequisite to a finding of impermissible trapping of costs and any such conclusion is foreclosed here by the Supreme Court's determination [in *Arcadia* v. *Ohio Power Co.*,

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[1] Under Section 13(b) of PUHCA, any attempt by a utility subsidiary to purchase goods or services from an affiliated company is illegal "except in accordance with such terms and conditions * * * as the [SEC] by rules and regulations or order shall prescribe." 15 U.S.C. 79m(b). Section 13(b) goes on to state that the "rules and regulations or order[s]" must, *inter alia*, "insure that such contracts are performed * * * at cost," subject to certain exceptions not applicable here. Thus, if Ohio Power's transactions with its subsidiary, SOCCO, were not performed pursuant either to SEC rules or SEC orders, those transactions would be per se illegal under PUHCA. For those transactions to be permissible at all, some form of SEC approval was necessary. Nothing in PUHCA, the SEC regulations, see 17 C.F.R. 250.90-250.92, or the opinion of the court of appeals suggests that the form of SEC approval—whether by general regulations or orders in specific cases—is of any significance to the issues in this case.

111 S. Ct. 415 (1990)] that the SEC and FERC are not regulating the same subject matter." FERC C.A. Br. 20.[2] The court of appeals appears to have understood FERC's argument plainly enough, but chose to reject it. See Pet. App. 10a (stating that the court was "unpersuaded" by the argument that FERC and SEC jurisdiction are not in conflict). Consequently, our primary submission before this Court is that the question "whether there was a general conflict between regulation of Ohio Power's rates under the FPA and the requirements of PUHCA * * * had essentially been decided [adversely to respondent] by this Court in its application of Section 318 to this case." Pet. 14-15. That submission is identical to FERC's position before the court of appeals. There is no doubt that it is squarely and properly before this Court on this petition.

FERC did advance an additional, alternative argument before the court of appeals that, after consultation with the SEC, we have not pressed in our petition for certiorari—namely, the argument that FERC's market-based price standard could be applied to Ohio Power's pass-through of its captive coal costs to its ratepayers because the SEC orders imposed only a ceiling, not a floor, for those costs. Thus, as respondent states, FERC did argue that "if [the SEC] orders established only a ceiling price, 'Ohio Power could not possibly have reasonably relied on the SEC's orders as guaranteeing recovery . . . of its cost

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[2] FERC argued at some length in support of that conclusion in the first section of its brief, see FERC C.A. Br. 21-25, and in its petition for rehearing, see FERC C.A. Reh'g Pet. 6-13; see *id.* at 12 (discussing panel's failure "to determine whether, on the facts of this case, there was a basis for equitable reliance by Ohio Power that would render FERC's rate not 'just and reasonable' ").

of purchasing . . . coal from [Southern Ohio].'" Br. in Opp. 18 (quoting FERC C.A. Br. 21).[3] Because we continue to believe, as we did in the prior proceedings in this Court, that the meaning of the particular SEC orders on this point is "of no general legal significance," 89-1283 Gov't Br. 36, we do not challenge the court of appeals' interpretation here. But that does not establish that the argument that we do advance in our petition was not also presented to, and rejected by, the court of appeals. That argument is now squarely before this Court.

2. Finally, although the point is not essential to this Court's analysis of the case, respondent is mistaken in asserting that "FERC affirmed and adopted the findings of its Administrative Law Judge that Ohio Power acted prudently in using coal from Southern Ohio and that Southern Ohio efficiently operated the mine supplying the coal in question." Br. in Opp. 23; see also Br. in Opp. 6, 12. In support of that proposition, respondent cites the boilerplate statement in FERC's opinion that the ALJ's decision "is affirmed and adopted to the extent it is not inconsistent with this Opinion and order." Pet. App. 80a. As relevant here, however, the ALJ's findings are inconsistent with FERC's decision.

FERC noted the ALJ's finding that evidence in the case "created a serious doubt as to whether the price

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[3] It is clear that this was an alternative argument, for it began with the words "[i]n any event" and was placed under its own heading in a distinct section of FERC's brief. See FERC C.A. Br. 25-27. It followed the section explaining that this Court's prior decision established that there was no general conflict between FERC's regulation of Ohio Power's disposition of electricity through a market-price test and the SEC's regulation of Ohio Power's acquisition of coal through a cost-based methodology. See FERC C.A. Br. 21-25.

paid for [SOCCO] coal was prudent" and held that respondent had not carried its burden to "dispel the doubts raised by the staff's evidence and did not prove affirmatively that its fuel costs were reasonable."[4] Pet. App. 72a. FERC's determination, after an exhaustive analysis, that respondent could have purchased coal of precisely comparable characteristics during the period in question at a lower price can hardly be said to have affirmed the ALJ's statement that Ohio Power acted prudently in purchasing higher-priced SOCCO coal.

In the end, however, FERC found it unnecessary to resolve the prudence question, because application of its market-based test was not dependent upon a finding of imprudence. See Pet. App. 85a. As a result, the question for the court of appeals on remand from this Court was whether the rate FERC prescribed on that basis was "just and reasonable" under all the circumstances, including the SEC's approval of the capitalization of SOCCO and its permission for respondent to purchase coal from SOCCO at cost. In assessing the relevance of the SEC's actions to the "just and reasonable" inquiry in a case such as this, it would be necessary (if the issue were raised by the utility) to consider, *inter alia*, the nature and extent of any justifiable reliance by the utility on the SEC orders, the extent to which Ohio Power has recovered

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[4] FERC examined respondent's costs of coal in comparison with other available coal supplies, while considering adjustments for every conceivable variable, including the sulfur and heat content of the coal (Pet. App. 60a-62a), the vintage of the contracts (*id.* at 62a-65a), the location of the consuming power plant and transportation costs (*id.* at 65a-66a), the geographical area of comparison (*id.* at 66a-67a), the reliability of an affiliate coal supply (*id.* at 67a), and the type of mine involved (*id.* at 67a-68a).

its initial investment in its coal subsidiary, and whether surrounding circumstances have changed so that any reliance on the SEC orders is no longer justifiable. See Pet. 20. Tellingly, however, respondent does not argue in this Court that the rates prescribed by FERC are not "just and reasonable" if the matter is viewed in this more tailored manner, in light of respondent's own investments, expectations, and surrounding circumstances. Like the court of appeals, respondent relies solely on the proposition that FERC is absolutely barred from even conducting such an inquiry. That proposition is fundamentally unsound as a matter of law, for the reasons stated herein and in our certiorari petition. Because of the broad impact of the decision below on the ability of FERC and state agencies to regulate rates charged by utilities that engage in inter-affiliate transactions (see Pet. 25-26)—an impact that respondent does not dispute—review of the decision below is warranted.

Respectfully submitted.

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